

**Audit Results From  
CAFR and Single Audit Procedures**

**Department of Transportation**

**For the Year Ended  
June 30, 2003**

**STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY**

**Department of Audit  
Division of State Audit**

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**Department of Transportation  
For the Year Ended June 30, 2003**

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**Department of Transportation  
For the Year Ended June 30, 2003**

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**EXECUTIVE SUMMARY**

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**Findings**

- FINDING 1     The department should improve controls over construction-in-progress. The department does not have an effective means of ensuring that all completion notices are appropriately submitted to the fiscal office. Seventeen of 54 construction-in-progress projects tested (31%) were actually completed prior to June 30, 2003, resulting in \$302,722,525 of misclassified assets. Furthermore, the fiscal office has not adequately reviewed the listing of construction-in-progress projects for reasonableness.
- FINDING 2     DOT management did not ensure departmental policies and procedures were followed regarding the Davis-Bacon Act. As noted in 15 of the past 19 years (beginning with the year ending June 30, 1984), department personnel do not always adhere to the policies and procedures established by the department to monitor classifications and wage rates as required by the Davis-Bacon Act. Interviews with laborers and mechanics to help ensure contractors' wage compliance were not always conducted.

This report addresses reportable conditions in internal control and noncompliance issues found at the Department of Transportation during our annual audit of the state's financial statements and major federal programs. The scope of our audit procedures at the Department of Transportation was limited. During the audit for the year ended June 30, 2003, our work at the Department of Transportation focused on the Highway Fund, a major fund in the *Tennessee Comprehensive Annual Financial Report*. Our audit of the fund included determining whether the department had an adequate system of internal control over financial reporting. We also performed certain audit procedures to obtain reasonable assurance about whether the State of Tennessee's financial statements were fairly presented. In addition, our work at the Department of Transportation included one major federal program: Highway Planning and Construction. We audited this federally funded program to determine whether the department complied with certain federal requirements and whether the department had an adequate system of internal control over the program to ensure compliance. Management's response is included following each finding.



STATE OF TENNESSEE  
**COMPTROLLER OF THE TREASURY**  
State Capitol  
Nashville, Tennessee 37243-0260  
(615) 741-2501

John G. Morgan  
Comptroller

April 22, 2004

The Honorable Phil Bredesen, Governor  
and  
Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243

and  
The Honorable Gerald F. Nicely, Commissioner  
Department of Transportation  
Suite 700, James K. Polk Building  
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith are the results of certain limited procedures performed at the Department of Transportation as a part of our audit of the *Comprehensive Annual Financial Report* of the State of Tennessee for the year ended June 30, 2003, and our audit of compliance with the requirements described in the U.S. Office of Management and Budget Circular A-133 Compliance Supplement.

Our review of management's controls and compliance with laws, regulations, and the provisions of contracts and grants resulted in certain findings which are detailed in the Findings and Recommendations section.

Sincerely,

John G. Morgan  
Comptroller of the Treasury

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**STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY  
DEPARTMENT OF AUDIT  
DIVISION OF STATE AUDIT**

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December 15, 2003

The Honorable John G. Morgan  
Comptroller of the Treasury  
State Capitol  
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have performed certain audit procedures at the Department of Transportation as part of our audit of the financial statements of the State of Tennessee as of and for the year ended June 30, 2003. The scope of our work included the Highway Fund, a major fund in the *Tennessee Comprehensive Annual Financial Report*. Our objective was to obtain reasonable assurance about whether the State of Tennessee's financial statements were free of material misstatement. We emphasize that this has not been a comprehensive audit of the Department of Transportation.

We also have audited certain federal financial assistance programs as part of our audit of the state's compliance with the requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement. The following table identifies the State of Tennessee's major federal program administered by the Department of Transportation. We performed certain audit procedures on this program as part of our objective to obtain reasonable assurance about whether the State of Tennessee complied with the types of requirements that are applicable to each of its major federal programs.

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**Major Federal Program Administered by the  
Department of Transportation  
For the Year Ended June 30, 2003  
(in thousands)**

<u>CFDA Number</u>	<u>Program Name</u>	<u>Federal Disbursements</u>
20.205	Highway Planning and Construction	\$530,613

Source: State of Tennessee's Schedule of Federal Financial Assistance for the year ended June 30, 2003.

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The Honorable John G. Morgan  
December 15, 2003  
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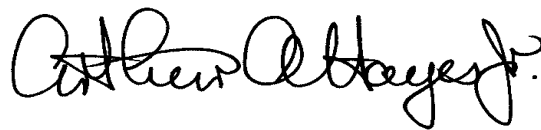
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards contained in Government Auditing Standards, issued by the Comptroller General of the United States.

We have issued an unqualified opinion, dated December 15, 2003, on the State of Tennessee's financial statements for the year ended June 30, 2003. We will issue, at a later date, the State of Tennessee *Single Audit Report* for the same period. In accordance with *Government Auditing Standards*, we will report on our consideration of the State of Tennessee's internal control over financial reporting and our tests of its compliance with certain laws, regulations, and provisions of contracts and grants in the *Single Audit Report*. That report will also contain our report on the State of Tennessee's compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB Circular A-133.

As a result of our procedures, we identified certain internal control and/or compliance issues related to the major federal program at the Department of Transportation. Those issues, along with management's response, are described immediately following this letter. We have reported other less significant matters involving the department's internal control and instances of noncompliance to the Department of Transportation's management in a separate letter.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

A handwritten signature in black ink, reading "Arthur A. Hayes, Jr." in a cursive script.

Arthur A. Hayes, Jr., CPA,  
Director

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## FINDINGS AND RECOMMENDATIONS

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### 1. The department should improve controls over construction-in-progress

#### Finding

The Department of Transportation (DOT) needs better accounting controls to identify completed construction projects. Seventeen of 54 construction-in-progress projects tested (31%) were actually completed prior to June 30, 2003. Department of Finance and Administration's Position Paper 10, "GASB 34 Implementation—Reporting Infrastructure Assets," states, "Construction in progress reported on the Statement of Net Assets will include infrastructure capital construction projects' life-to-date expenditures for which a Completion Notice has not been received by DOT's fiscal office." Department of Transportation engineers issue completion notices when a construction project has met all standards and is considered finished. A copy of the completion notice is required to be filed with DOT's fiscal office. The fiscal office then reclassifies the project from construction-in-progress to infrastructure in accordance with Position Paper 10. The testwork found \$302,722,525 of misclassified assets. For example, Saturn Parkway, which was completed in 1992, was still listed as construction-in-progress. For each of the 17 misclassified projects, a completion notice was located within the Department of Transportation although a copy was not available in the fiscal office. The department does not have an effective means of ensuring that all completion notices are appropriately submitted to the fiscal office.

Furthermore, the fiscal office has not adequately reviewed the listing of construction-in-progress projects for reasonableness. As part of the audit, the department generated a listing of all construction-in-progress projects that included the project's balance of life-to-date expenditures at July 1, 2001 (the date the state elected to implement reporting infrastructure); the additional expenditures incurred during each of the fiscal years ended June 30, 2002, and June 30, 2003; and the additional expenditures incurred to date in the fiscal year ending June 30, 2004. Based on the overall review of this report, many of the projects listed appear to be completed rather than in progress because there were no expenditures reported in any of the fiscal years reported—the project balances remained unchanged from July 1, 2001, through December 2003. In addition, the fiscal office has not reviewed the listing for miscoded data in certain information fields such as projects with maintenance indicators in the status code field instead of construction or projects coded to construction when they were actually maintenance.

The state began reporting its infrastructure assets in 2002 with the implementation of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. Although the initial reporting of infrastructure assets was expected to involve the broad use of estimates, the information was expected to improve and become more reliable over time. If the department does not monitor and review the new information as it becomes available, the accuracy of the reported amounts will deteriorate rather than improve.



## **Recommendation**

The department should implement procedures to ensure that all completion notices are submitted to the fiscal office. The fiscal office should review the year-end construction-in-progress reports and investigate any projects that appear to be completed to confirm that it has received the completion notices from engineering. Proper adjustments should be made for removal of projects from construction-in-progress to infrastructure roadways or bridges. In addition, the fiscal office should review the construction-in-progress listing for miscoded data and make the necessary corrections.

## **Management's Comment**

We concur. Infrastructure asset reporting is a new and complicated process. The department's implementation of GASB 34 reporting was as of June 30, 2002, and required identifying all projects as to: on system or off system; phase of work; capital or maintenance; bridge, roadway, or both; completed or in-process. During the audit we developed a report to assist the auditors' review of construction-in-progress projects. This report was used to identify projects potentially misclassified as construction-in-progress rather than completed. In the future, this report will be generated before year-end reporting and any project indicated as possibly completed will be investigated.

In addition, data element edits are being added to the system to reduce miscoding of data and a report is being developed to enable us to find and correct any existing projects with miscoded data.

## **2. DOT management did not ensure departmental policies and procedures were followed regarding the Davis-Bacon Act**

### **Finding**

The Department of Transportation has established program policies and procedures to comply with the Davis-Bacon Act. However, as noted in 15 of the past 19 years (beginning with the year ending June 30, 1984), department personnel do not always adhere to these policies and procedures to monitor classifications and wage rates as required by the Davis-Bacon Act.

The Davis-Bacon Act requires laborers and mechanics employed by contractors or subcontractors on federal contracts to be paid no less than the prevailing wage rates established for that locale by the U.S. Department of Labor. To monitor compliance with this requirement, the department has established a system whereby designated personnel check contractor and subcontractor payrolls during each month of a project. Also, the project engineer or his representative is required to conduct a specific number of interviews with laborers and mechanics to verify the accuracy of payroll records examined. A separate interview form is completed and signed by the laborer or mechanic and the project engineer to document each interview. In response to prior findings, the department issued Circular Letter 1273-03, which,

as amended, requires that the project engineer conduct interviews at two-month intervals with a minimum of three interviews every two months, or a minimum of two interviews on contracts not anticipated to last two months. These interviews provide evidence of on-site visits to monitor classifications and wage rates.

For 16 of 40 closed construction contracts tested (40%), the project engineers had not always conducted a sufficient number of interviews. Of the 16, 12 contracts had no labor interviews conducted. The duration of these projects ranged from one month to 14 months. The number of interviews required by the Circular Letter ranged from at least 2 interviews to 21 interviews. Four contracts did not have a sufficient number of interviews conducted. These 4 contracts were from 4 to 11 interviews short of the number of interviews required by the Circular Letter. Without a sufficient number of labor interviews, management cannot have adequate assurance of compliance with the Davis-Bacon Act.

Management has concurred with the 15 previous findings. In both of the two most recent audits, management stated, “The requirement to perform employee interviews has continued to be a problem.” After describing some of the specific obstacles in the interview process, management further stated, “We feel that the time involved in the interview process is not justified by the results. However, we do understand that the interview process is required and we are exploring ways to make this more manageable.” Management discussed the Davis-Bacon requirements with the Federal Highway Administration (FHWA) and requested information from other Departments of Transportation. Management indicated that once the information was gathered and reviewed with FHWA, Circular Letter 1273-03 would be revised. However, no changes to Circular Letter 1273-03 have been made.

### **Recommendation**

Management should ensure departmental policies and procedures established to monitor compliance with the Davis-Bacon Act are followed for all projects, including labor interviews providing evidence of on-site visits to monitor classifications and wage rates. If a change to the current interview process is warranted, management should prioritize revision to Circular Letter 1273-03.

### **Management’s Comment**

We concur. While this has frequently been a problem in the past, we are committed to developing and following procedures that comply with the Davis-Bacon Act. Therefore, effective January 1, 2004, Circular Letter 1273-03 was revised to require a minimum of one interview per month for each federal aid contract. In addition, the project supervisor will be required to certify that labor interviews for the month have been performed or if not, explain why. A certification statement will be added to the Engineers Estimate of Quantities (EEQ), which must be submitted and signed by the project supervisor before payments are made to the contractor for construction work.

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## STATUS OF PRIOR AUDIT FINDINGS

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### State of Tennessee *Single Audit Report* for the year ended June 30, 2002

Audit findings pertaining to the Department of Transportation were included in the *Single Audit Report*. The updated status of these findings as determined by our audit procedures is described below.

#### **Resolved Audit Findings**

The current audit disclosed that the Department of Transportation has corrected the previous audit findings concerning the inadequate documentation of the Department of Transportation State Transportation Accounting and Reporting System (DOT STARS) disaster recovery plan and the inadequate controls over programmer access to DOT STARS production data sets.

#### **Repeated Audit Finding**

The current audit disclosed that the Department of Transportation has not corrected the previous audit finding concerning the failure to follow departmental policies to ensure compliance with the Davis-Bacon Act. This finding will be repeated in the *Single Audit Report* for the year ended June 30, 2003.

### Most Recent Financial and Compliance Audit

Audit report number 02/101 for the Department of Transportation, issued in May 2003, contained an audit finding that was not included in the State of Tennessee *Single Audit Report*. This finding was not relevant to our current audit and, as a result, we did not pursue its status as a part of this audit.